

## INTRODUCTION: BACKGROUND INFORMATION

### Table of Contents

1. Authority and Purpose .....	Page 2
• Mission Statement (See also Board Charter 1.00.100)	
• Creation of the Washington State Investment Board	
2. Fiduciary Responsibility .....	Page 3
• What is a Fiduciary?	
• Fiduciary Responsibility	
• Fiduciary Principles	
• Investment Principles Of The Board	
3. Funding .....	Page 5
• Funding the State Investment Board	
4. Investment Portfolio.....	Page 6
• Funds Managed	
• Strategic Asset Allocation	
5. Organization and Role Definition.....	Page 8
• State Investment Board Members	
• Positions on the Board	
• Staffing of the State Investment Board	
• The Executive Director	
• State Investment Board Organization	
• Legal Counsel	
• Consultants, Advisors, Managers	
6. Relationship to Other Agencies .....	Page 11
• Joint Committee on Pension Policy	
• Office of State Actuary	
• Department of Retirement Systems	
• State Advisory Committee to the Department of Retirement Systems	
• State Finance Committee	
• State Treasurer	
7. Conflict of Interest .....	Page 14
• Conflict of Interest Background	
• Employment Restrictions	
8. Public Disclosure Requirements .....	Page 15
• Public Disclosure Commission Filing	
9. Compensation .....	Page 16
• Meeting Compensation	
• Eligibility	

## INTRODUCTION: BACKGROUND INFORMATION

### 1. AUTHORITY AND PURPOSE

#### Mission Statement

The mission of the State Investment Board is to invest and manage the entrusted funds in a manner consistent with statutes, regulations, Board policies and the highest standards of professional conduct for the exclusive benefit of the fund beneficiaries.

#### Creation Of The Washington State Investment Board

In 1981, the Washington State Legislature created a fourteen-member Board to "... exercise all powers and perform all duties prescribed by law with respect to public trust and retirement funds." (RCW 43.33A.010).

The Legislature gave the State Investment Board (Board) the responsibility to invest and manage retirement funds contributed by public employers and employees. This responsibility is further defined in RCW 43.84.150: "... the State Investment Board shall have full power to invest, reinvest, manage, contract, or sell or exchange investments acquired."

The State Investment Board is a public organization operating as part of the Executive Branch of state government. As a state agency, Board members and staff are required to comply with all statutory requirements and rules followed by other agencies, officials, and employees in the performance of their public duties. These responsibilities and requirements include, but are not limited to, budgeting and expenditures, contracting, procurement, personnel, accounting and financial reporting, public disclosure, public notice and open meeting laws.

The Board fulfills its role and carries out its responsibility in part by its own specific actions. However, a large portion of the Board's responsibilities is carried out through its staff. The Board adopts the policies and procedures which the staff follow to carry out their duties to the Board and to the beneficiaries of each trust.

#### References:

RCW 43.33A, State Investment Board

Appendix A

RCW 43.84, Investment and Interfund Loans

Appendix A

## INTRODUCTION: BACKGROUND INFORMATION

### 2. FIDUCIARY RESPONSIBILITY

#### What Is A "Fiduciary"?

Fiduciary is a term encompassing a variety of relationships in which one party has to act for the benefit of another. There are many different types of fiduciary relationships including attorney and client, agent and principal, and partners in a partnership.

Members of the State Investment Board are considered fiduciaries for the trust funds they invest and manage.

#### Fiduciary Responsibilities

The following paragraphs briefly discuss the fiduciaries' responsibilities and liabilities:

1. **Duty to use the appropriate standard of care.** This duty would include the duty to invest in accordance with the prudent person rule, to exercise care, skill and caution. This duty is also reflected in RCW 43.33A, which sets out the standard of care for investments.
2. **Duty of loyalty.** Board members may not use their position for personal gain or self-dealing. Board members may not receive financial benefit from their positions as trustees.

Board members are subject to the restrictions and prohibitions in RCW 42.18, the Executive Conflict of Interest Act. This act, among other things, prohibits a person from using his or her position with the state for personal gain or self-dealing. This act also prohibits non-voting members from receiving financial benefit by virtue of their position on the Board.

3. **Duty to diversify.** This duty is part of the duty to preserve the trust property and make it productive. This duty is described in RCW 43.84.150 which gives the Board authority to invest and also establishes certain parameters for these investments, including the duty to diversify. This statute applies to the entire Board and does not exempt non-voting members.

In giving an opinion and advice to the voting members, non-voting members must remember they are also bound by the same general fiduciary responsibilities as applicable to the voting members of the board.

## INTRODUCTION: BACKGROUND INFORMATION

### Investment Principles Of The Board

The two general investment principles which guide the Board are briefly described below:

#### *Prudent Person*

The law gives the Board very broad authority to invest retirement and other funds with very few limitations except to act as a "prudent person" would act.

The term "prudent person" is well-defined in common and case law. It simply means that if the courts are asked to judge the actions of the Board, they can rely on simple common sense. Did the Board act intelligently and responsibly? When they decided on investments did they try to understand the risks? The probable outcome? Or were they careless and did they speculate with the trust funds? These are simple non-scientific questions that would help the courts decide whether Board members were acting as "prudent persons" or not.

Another test a court may use is to decide whether other persons of intelligence would have acted in a similar manner under similar circumstances. Again, the test of common sense must be brought to bear on the actions of fiduciaries.

If the Board members do not act as "prudent persons" they may be held personally liable for damages by the courts.

#### *Exclusive Benefit*

Another principle often cited is the "exclusive benefit" rule. This means that the Board members are legally obligated to act for the exclusive benefit of the fund beneficiaries. No other objective is acceptable or legally defensible.

### References:

RCW 42:18, Executive Branch Conflict of Interest Act

Appendix A

## INTRODUCTION: BACKGROUND INFORMATION

### 3. FUNDING

#### **Funding The State Investment Board**

Funding for the State Investment Board is from earnings on the assets managed. The Board receives no state tax monies. The Board is, therefore, referred to as a "non-general fund" agency for budgetary purposes. There are two ways portions of earnings are spent.

##### *The Biennial Budget (Appropriated)*

The State Investment Board follows the same budget process as any other state agency. The Board receives a biennial (two-year) appropriation from the legislature, which covers normal department operation, including staff, facilities, equipment, supplies, etc.

The biennial budget is approved by the state legislature every odd-numbered year. The biennial budget funds the agency from July 1 of the odd-numbered year, following passage of the state budget, to June 30 of the next odd-numbered year.

Like any other state agency, the Board cannot operate in a deficit.

##### *Investment Expenses (Non-Appropriated)*

Fees and expenses related to the making or managing of investments are paid directly from investment earnings. Typically, these expenses include money manager, master custodial, consultant, and legal fees specifically related to an investment or group of investments.

These expenses are classified as non-appropriated expenditures which do not require specific legislative appropriation.

Statutory authority for these expenditures is codified in RCW 43.84.160: "**Investment counseling fees payable from earnings.** Investment counseling fees established by contract shall be payable from the investment earnings derived from those assets being managed by investment counsel."

## INTRODUCTION: BACKGROUND INFORMATION

### 4. INVESTMENT PORTFOLIO

#### **Funds Managed**

Currently, the State Investment Board manages over \$50 billion in retirement, industrial insurance, permanent, and other trust funds. It has management responsibility for 31 funds which are categorized in four classes: the retirement funds, the industrial insurance trust funds, permanent, and other trust funds.

#### *Retirement Funds*

The 13 retirement or pension funds comprise the largest class of funds under the investment control of the Board. Approximately three quarters of the total funds managed are retirement funds.

#### *Deferred Compensation Funds*

The state deferred compensation plan is a retirement savings program for state employees.

#### *Insurance (Labor and Industries) Funds*

There are four funds commonly referred to as the Labor and Industries funds or industrial insurance funds. These funds are derived from insurance premiums paid by employers and employees throughout the state and are used to pay disability, medical, and death benefits to beneficiaries. These funds represent approximately one-seventh of the total funds managed.

#### *Permanent Funds*

There are six permanent funds. With the exception of the very small Millersylvania Park Trust, the permanent funds are land grant funds whose earnings are dedicated to the capital development and the maintenance of facilities and equipment at common schools and institutions of higher education. The permanent funds typically represent less than two percent of the total funds managed.

#### *Other Trust Funds*

There are seven other trust funds created by the state which are invested by the State Investment Board. These funds are the Game and Special Wildlife Fund, the State Employees Insurance Reserve, the Radiation Perpetual Fund, the Reclamation Revolving Fund, Guaranteed Education Tuition, the Developmental Disabilities Endowment Trust, and the State Emergency Reserve Fund. These funds represent less than two percent of the total funds managed.

## INTRODUCTION: BACKGROUND INFORMATION

---

### **Asset Allocation**

One of the fiduciary duties of the State Investment Board is the duty to diversify. The Board makes investments from these eligible investments:

- 1) Short-term Fixed Income
- 2) Long-term Fixed Income
- 3) Common Stocks and Equivalents
- 4) Leveraged Buyout and Venture Capital Limited Partnerships
- 5) Special Situations
- 6) Real Estate Equity and/or Debt

To maintain the desired diversification, the Board has adopted asset allocation policies. Monthly, Board staff report the current allocation of assets with a comparison of how allocations match the Board adopted ranges for each asset class.

Asset allocation policies are periodically reviewed by the Board and can be changed or retained depending on the results of studies and long-term market expectations.

## INTRODUCTION: BACKGROUND INFORMATION

### 5. ORGANIZATION AND ROLE DEFINITION

#### State Investment Board Members

The state Investment Board is comprised of fourteen members. Nine are voting members, which include three ex-officio members, one legislator from each house, and four representatives of various stakeholders in the public employee pension systems. Five are non-voting members, directed by statute to be considered “experienced and qualified in the field of investments.”

Membership on the Board, terms, and nomination or appointment procedures are spelled out in RCW 43.33A.020. Nominations for non-voting members are submitted to the Board by the Audit Committee. Candidates may be referred or recommended to the Audit Committee by anyone. (See Appendix G of this Handbook for outline of specifications for non-voting members).

A list of current Board members, representation, term of appointment, mailing address and telephone number is included in Appendix B of this Handbook.

#### Positions On The Board

##### *Chair:*

The Board elects a Chair annually from among the members who are not legislators. Legislative members and non-voting members are not eligible to serve as Chair.

##### *Vice-Chair:*

The Board also elects a Vice-Chair annually. All members except legislative members and non-voting members are eligible to serve as Vice-Chair.

#### Staffing Of The State Investment Board

The State Investment Board is a state agency of general government. Senior management, confidential secretary and investment officer positions are exempt from Washington State civil service law. All others are classified civil service positions. All State Investment Board staff are state employees. A list of current staff is included in Appendix D of this Handbook.

#### The Executive Director

The day-to-day operation of the State Investment Board is under the direction of an Executive Director appointed by the Board. The Director is the chief staff person of the Board.

The law provides for the selection of an Executive Director by the State Investment Board. The State Finance Committee ratifies the appointment. The Board may delegate to the Executive Director such authority as it wishes the Executive Director to exercise. The Executive Director may delegate to Board staff any of the Executive Director’s powers and duties.



## INTRODUCTION: BACKGROUND INFORMATION

Unless otherwise determined by the Board, the Chief Investment Officer shall assume the duties of the Executive Director while the Executive Director is absent for other than business reasons.

### **State Investment Board Organization**

The State Investment Board organization is divided into two major units: Investments and Operations. Both are under the direction of the Executive Director. An organization chart is included in Appendix E of this Handbook.

The functions of both major units are described below.

#### *Investment Staff*

The Investment arm of the organization is staffed with investment professionals experienced and skilled in various institutional investment specialties.

This staff makes daily buy and sell decisions on various securities in addition to conducting oversight and monitoring of all outside managers, advisors and consultants.

#### *Operations Staff*

The Operations arm of the State Investment Board organization supports the investment activity. The Operations staff ensures State Investment Board activities comply with the spirit and the letter of the law governing agency programs.

Operations staff are not investment professionals, but are skilled and experienced in administration, accounting, personnel, budgeting, procurement, contract administration, data processing, and general public administration matters.

### **Legal Counsel**

Legal counsel to the State Investment Board is provided through the Office of the Attorney General. The Attorney General's Office is charged with providing legal services including advising and representing the State Investment Board and in defending Board members and employees for actions performed while in their official capacity.

In addition, the State Investment Board also contracts for outside legal services if the specific expertise is not available through the Attorney General's Office.

## INTRODUCTION: BACKGROUND INFORMATION

### **Consultants, Advisors, Managers**

#### *Reason for Hiring Outside Managers*

Some pension agencies hire outside managers to invest all of the assets. A few pension agencies invest and manage all assets with internal staff. The State Investment Board, like most fund sponsors, has found a combination of internal and external approach to be the best solution.

Since the members of the Board are not investment experts, it is critical that they have the advice of experts in the investment business. Advice is often solicited from more than one source to ensure full consideration and evaluation of all alternatives.

Outside consultants, advisors and managers are a source of advice, counsel and services, which the Board and staff use to ensure the best combination of skills and advice necessary to maximize the return on the assets of the fund. This gives the State Investment Board a depth of highly skilled persons to perform specific tasks and to extend the capability of the State Investment Board. A list of current key advisors, consultants, and money managers used by the Board is periodically distributed to members in Board packets.

With the assistance of staff and consultants, the Board decides whether a certain type of asset, or a portion of that asset can be best invested and/or managed by internal Board staff or by hired managers. The advice of consultants is considered when making investment decisions.

If managers are hired, the staff and Board must oversee their activities to ensure compliance with contract terms and Board objectives.

#### *Selection Process*

Selecting investment consultants, advisors and managers is a competitive and public process. The Board oversees and ultimately approves the issuance of a Request for Proposal (RFP). The RFP lists the requirements and services to be provided. RFPs are advertised and sent to a large number of potential bidders.

Once the proposals are received, they are reviewed and evaluated by staff. Sometimes consultants may assist with the evaluation of the proposals received. Staff selects a group of finalists based upon a variety of factors, including price. Interviews are then conducted by staff, the Board, or one of the Board Committees. The final selection is usually made by or approved by the full Board.

### **References:**

Members of the State Investment Board  
State Investment Board Staff  
State Investment Board Organizational Charts

Appendix B  
Appendix D  
Appendix E

## INTRODUCTION: BACKGROUND INFORMATION

### 6. RELATIONSHIP TO OTHER AGENCIES

Seven other agencies and committees have various authorities in the administration of the retirement systems and investment program. A chart illustrating various governmental relationships is included in Appendix F of this Handbook.

#### *Select Committee on Pension Policy*

The Select Committee on Pension Policy (SCPP) was established through new legislation signed into law on July 27, 2003.

The new law repealed the Joint Committee on Pension Policy (JCPP) and except for the duty of appointing and removing the State Actuary, assigned the JCPP duties to the SCPP. The duty of appointing and removing the State Actuary was assigned to the State Actuary Appointment Committee.

The SCPP is composed of 20 members including four members of the Senate, four members of the House of Representatives, four members representing active employees, two members representing retired employees, four employer representatives, and the directors of the Department of Retirement Systems and Office of Financial Management.

The Select Committee's duties are to:

- Make recommendations to the Legislature on pension and pension funding policies.
- Study the financial condition of the state's pension system and make recommendations to the Pension Funding Council on the results of actuarial audits of contribution rates and assumptions the Pension Funding Council conducts.

The Committee holds open meetings throughout the year and reviews recommendations for additions or revisions to the legislation that governs the administration of the state retirement systems.

#### *State Actuary Appointment Committee*

The State Actuary Appointment Committee consists of eight members and has the power to appoint or remove the State Actuary by a two-thirds vote. Four members of the Committee are the chairs and ranking minority members of the House of Representatives Appropriations and the Senate Ways and Means committees, and four are members of the SCPP, including one member representing active and retired employees and one member representing employers.

The Appointment Committee may be convened by the chairs of the House Appropriations and the Senate Ways and Means committees whenever the position becomes vacant or upon the written

## INTRODUCTION: BACKGROUND INFORMATION

request of four members of the Appointment Committee.

### *Office of the State Actuary*

The Office of the State Actuary was established as a Legislative agency by the 1976 Legislature. RCW 44.44 sets forth the duties for the office:

- Perform all actuarial services for the state retirement systems. These include the Public Employees, Teachers, Law Enforcement Officers and Fire Fighters, Judicial and Washington State Patrol Retirement Systems. Experience studies of the major retirement systems are conducted at least every six years.
- Advise the Legislature and Governor on pension benefits and funding. The State Actuary also consults with the Legislature and Governor concerning the actuarial assumptions used by the retirement systems.
- Prepare fiscal notes on each pension bill introduced in the Legislature. These notes explain the financial impact proposed legislation will have on state retirement systems.
- Provide staff support to the Joint Committee on Pension Policy.

### *Department of Retirement Systems*

The Department of Retirement Systems (DRS) was established by the Legislature in 1976 under RCW 41.50. The primary function of DRS is to administer the 14 public employee retirement systems. These systems are:

- Public Employees' Retirement System, Plans I, II, and III (PERS)
- Teachers Retirement System, Plans I and II, and III (TRS)
- School Employees' Retirement System, Plans II and III (SERS)
- Law Enforcement Officers and Fire Fighters Retirement System, Plans I and II (LEOFF)
- Washington State Patrol Retirement System, Plans I and II (WSPRS),
- Judicial Retirement System (JRS)
- Judges Retirement Fund (JRF)

State Investment Board manages one fund (the Volunteer Fire Fighters' Relief and Pension Principal) that is not administered through the Department of Retirement Systems. The Judges Retirement Fund no longer has active or contributing members and has been replaced by the Judicial Retirement System.

Responsibilities of the Department are to:

## INTRODUCTION: BACKGROUND INFORMATION

- Maintain the files and records necessary to administer the retirement systems.
- Collect retirement contributions from employers and employees.
- Pay retirement benefits as prescribed by the provisions of the systems.
- Act as a trustee through the State Investment Board.
- Provide notification to retirement system members of their accumulated service credit.

The Director of the Department is appointed by the Governor with the consent of the Senate.

### *State Advisory Committee to the Department of Retirement Systems*

The State Advisory Committee to the Department of Retirement Systems serves in an advisory capacity to the Director. The Committee consists of twelve members appointed by the Governor as follows:

- Three active members and one retired member of the Public Employees' Retirement System;
- Two active members (a law enforcement officer and a fire fighter), and one retired fire fighter from the Law Enforcement Officers' and Fire Fighters' Retirement System;
- Two active members (a teacher and an administrator) and one retired member of the Teachers' Retirement System;
- One active member of the Washington State Patrol Retirement System;
- One active member of the Judicial Retirement System.

The active and retired members for PERS, TRS, LEOFF and WSPRS are selected from a list of three nominees submitted by each organization representing active and retired members. The member appointed for JRS is appointed from a list of three nominees submitted by the State Supreme Court.

The Advisory Committee also reviews all disability appeal cases reviewed by DRS' Hearings Examiner and makes recommendations to the DRS Director for the disposition of the appeal.

### *State Finance Committee*

The State Finance Committee is comprised of the Governor, Treasurer, and Lieutenant Governor of the state. In 1981, the Committee relinquished its authority for investments to the State Investment Board. The Committee ratifies the appointment of the Executive Director.

### *State Treasurer*

## INTRODUCTION: BACKGROUND INFORMATION

### 7. CONFLICT OF INTEREST

#### Conflict of Interest Policy

The Washington State Investment Board adopted a conflict of interest policy for Board members and staff at its September 1992 meeting. (An updated copy is included in Section 2.00 of this Handbook.)

The policy brings together existing state law, Washington Administrative Code (WAC), and the Governor's 1992 Executive Order on Ethics. According to the policy, "This reflects existing state laws regarding conflict of interest and code of ethics and is intended to supplement and clarify these standards as it (the conflict of interest) applies to this agency."

The policy covers gifts, travel, personal investments, conflicts of interest, use of position, and sanctions for violations.

#### Employment Restrictions

RCW 43.33A.060 specifies that "No member during the term of appointment may be employed by any investment brokerage or mortgage servicing firm doing business with the State Investment Board. A trust department of a commercial bank or trust company organized under federal or state law is not considered a mortgage servicing firm for purposes of this section."

#### References:

RCW 42.52, Ethics in Public Service	Appendix A
WAC 287-04, State Investment Board Administrative Rule, Conflict of Interest	Appendix A

## INTRODUCTION: BACKGROUND INFORMATION

### 8. PUBLIC DISCLOSURE COMMISSION FILING

The Public Disclosure Law requires anyone holding or seeking a state elected office, or holding a high-level appointed position, to file a statement of financial affairs.

RCW 42.17.2401 specifically requires the members of the State Investment Board to file with the Public Disclosure Commission (PDC). The financial affairs statement will cover the preceding 12 months. The information reported includes sources of income, real estate holdings, investments, creditors, business relationships and the identity of the major customers of those businesses.

Members of the State Investment Board and the Executive Director are among the state officers who file reports with the Public Disclosure Commission. Several members of the State Investment Board are required to file due to their position as elected officials, legislators, or agency heads.

According to the Code of Conduct, as adopted by the Board, all State Investment Board *exempt employees with investment management duties* are required to file a statement of financial affairs with the Public Disclosure Commission.

Filers should be aware that they are required to report to the Public Disclosure Commission between January 1 and April 15. After an initial PDC Form F-1, Personal Financial Affairs Statement is filed, an amended financial affairs statement, PDC Form F-1A may be filed for three years. The PDC Form F-1A will state that the information originally filed is essentially the same.

New Board members and staff are required to file within two weeks of appointment. Forms will be provided to Board members annually.

The Public Disclosure Commission has prepared a manual for completing the Personal Financial Affairs Statement. Copies of the manual and forms necessary to comply with the Public Disclosure Law may be obtained from the Public Disclosure Commission or the Board staff.

The Public Disclosure Commission may be contacted at:

711 Capitol Way, Suite 206  
Post Office Box 40908  
Olympia, Washington 98504-0908  
(360) 753-1111 Phone  
(360) 753-1112 Fax  
<http://www.pdc.wa.gov>

## INTRODUCTION: BACKGROUND INFORMATION

### 9. COMPENSATION

#### Meeting Compensation

Some Board members are eligible to be compensated for attending meetings. However, ex-officio Board members who are also state officials (agency directors, legislators, elected officials) and other public employees are not eligible for compensation.

Attendance is registered as part of the meeting minutes and payment will follow. Board members are paid through the state payroll system. Compensation is set by law at \$50 per day when attending meetings.

Official meetings include, but are not limited to, attendance at Board and Committee meetings, approved conferences and seminars, and other meetings approved by the Board Chair to carry out statutorily prescribed duties. Official meetings do not include informal meetings and telephone conversations between members.

Reimbursement for travel associated with conferences and seminars are subject to the guidelines set out in the Board Education Policy (Section 2.00.200).

#### Eligibility

The matrix on the following page shows the eligibility of members for meeting compensation and travel expense reimbursement through the State Investment Board.



## INTRODUCTION: BACKGROUND INFORMATION

### COMPENSATION AND TRAVEL EXPENSE REIMBURSEMENT ELIGIBILITY

MEMBER STATUS	MEETING COMPENSATION	TRAVEL EXPENSE REIMBURSEMENT
Representative - Retired Member Public Employees Retirement System	YES, if no longer in public employment	YES
Representative - Active Member Public Employees Retirement System	NO, if a public employee	YES
Representative – Active Member School Employees Retirement System	NO, if a public employee	YES
Non-Voting	YES, if not a public employee	YES
Director - Dept. of Retirement Systems	NO	YES
Director - Dept. of Labor and Industries	NO	YES
Representative - Law Enforcement Officers' Fire Fighters Retirement System	NO, if a public employee	YES
Representative - Teachers Retirement System	NO, if a public employee	YES
State Treasurer	NO	YES
State Representative	NO	NO
State Senator	NO	NO